

**REPORT ON ORGANIZATIONAL EXAMINATION
OF**

UNITED SPECIALTY INSURANCE COMPANY

AS OF

NOVEMBER 14, 2005

I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached ORGANIZATIONAL REPORT ON EXAMINATION, made as of NOVEMBER 14, 2005 of the

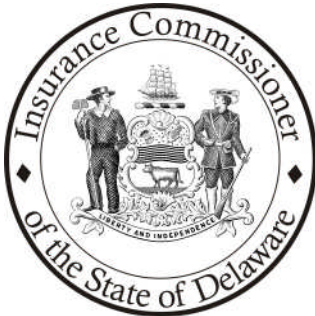
UNITED SPECIALTY INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY:

Antoinette Handy

DATE: 3 APRIL 2006



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 3RD DAY OF APRIL 2006.

Matthew Denn

Insurance Commissioner

REPORT ON ORGANIZATIONAL EXAMINATION
OF THE
UNITED SPECIALTY INSURANCE COMPANY
AS OF
NOVEMBER 14, 2005

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", is written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 3rd day of APRIL, 2006.

TABLE OF CONTENTS

| | |
|---|---|
| SALUTATION | 1 |
| SCOPE OF EXAMINATION..... | 2 |
| HISTORY | 2 |
| CAPITALIZATION | 3 |
| HOLDING COMPANY SYSTEM | 3 |
| MANAGEMENT AND CONTROL | 4 |
| CORPORATE RECORDS | 5 |
| TERRITORY AND PLAN OF OPERATION | 5 |
| AGREEMENTS..... | 6 |
| REINSURANCE..... | 6 |
| SECURITIES-ESCROW DEPOSIT | 6 |
| CASH ON DEPOSIT..... | 6 |
| FINANCIAL STATEMENT | 7 |
| Analysis of Assets..... | 7 |
| Liabilities, Surplus and Other Funds | 7 |
| SUMMARY OF GENERAL COMMENTS AND RECOMMENDATIONS | 8 |
| CAPITAL AND SURPLUS REQUIREMENTS..... | 8 |
| CONCLUSION..... | 9 |

SALUTATION

Honorable Matthew Denn
Insurance Commissioner
State of Delaware
841 Silver Lake Boulevard
Dover, Delaware 19904

Commissioner:

Pursuant to instructions contained in Certificate of Authority Number 05.033, an organizational examination has been made as of November 14, 2005 into the condition and affairs of the

UNITED SPECIALTY INSURANCE COMPANY

hereinafter referred to as "Company", chartered under the laws of the State of Delaware as a stock property and casualty insurance company.

The examination was conducted at the administrative office of the Company, located at 8200 Anderson Blvd, Fort Worth, TX 76120.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

This examination, covering the organization of the Company as of November 14, 2005, consisted of a general survey of the Company's corporate records and actions necessary for organization and determination of assets and liabilities.

This examination was conducted in accordance with Section 322 of the Delaware Insurance Code, which states that the Commissioner or one of his examiners shall examine each issuer applying for an initial certificate of authority to transact insurance in Delaware.

The report format is designed to present comments and recommendations as are deemed necessary or appropriate in those areas in need of correction, or improvement resulting from examination of the Company's corporate records, financial condition and market activities.

In addition to items hereinafter incorporated as part of the written report, the following subjects were reviewed and made part of the workpapers of this examination:

Corporate Records

Accounts and Records

HISTORY

The Company's Certificate of Incorporation, dated July 8, 2005, was filed with the office of the Secretary of State of Delaware on July 11, 2005, by its incorporator, Lyndal S. Stephens.

The registered office of the Company is located at 160 Greentree Drive, Suite 101, Dover, Kent County, Delaware 19904. The name of the resident agent upon whom process may be served is National Registered Agents, Inc.

CAPITALIZATION

In accordance with Article III of the Company's Certificate of Incorporation, the Company was authorized to issue 1,500 shares of common capital stock with no par value.

On November 14, 2005, the Company's direct parent, State National Insurance Company, Inc. (State National) purchased 1,500 shares of stock for \$20,000,000, giving the Company a total capitalization of \$15,000,000 capital and \$5,000,000 paid in surplus.

HOLDING COMPANY SYSTEM

The Company is a member of an Insurance Holding Company System, and a Holding Company Registration statement is in the process of being filed with the State of Delaware.

The Company's direct parent is State National Companies Inc, a Texas domiciled insurer with its ultimate controlling parent being State National Insurance Companies, Inc., a Delaware Chapter S Corp.

The following abbreviated chart illustrates the Company and its direct affiliates within the current Holding Company System as of January 10, 2005:

State National Companies, Inc. S Corp (Delaware)
SNC Financial GP, LLC (01%)(Nevada)
SNC Financial LP, LLC (99%)(Nevada)
T.B.A. Insurance Group, Ltd. (Texas)
State National Holdings, Inc. (Delaware)
State National Intermediate Holdings, Inc. (C Corp) (Texas)
State National Insurance Company, Inc. (Texas)
United Specialty Insurance Company (Delaware)

MANAGEMENT AND CONTROL

The Company's By-laws state that the business and affairs shall be managed by a Board of Directors consisting of not less than two (2) persons nor more than twenty-one (21).

The initial members of the Board of Directors, duly appointed in accordance with Article V of the Certificate of Incorporation dated July 8, 2005, were as follows:

| <u>Name</u> | <u>Principle Business Affiliation</u> |
|---------------------|---|
| Terry L. Ledbetter | President State National Companies |
| Lonnie K. Ledbetter | Chief Executive Officer State National Companies |

The Company's By-laws state that the Board of Directors should consist of not less than three (3) persons. The Company has only two (2) directors. Therefore,

It is recommended that the stockholders elect an additional director to comply with the By-laws.

Officers:

The By-laws provide that the officers of the Corporation shall consist of a President, one or more Vice Presidents if required by the Board, a Secretary and a

Treasurer, and such other officers as may be elected or appointed by the Board of Directors.

The elected officers of the Company, serving as of July 15, 2005, were as follows:

| <u>Name</u> | <u>Title</u> |
|----------------------------------|---|
| Terry L. Ledbetter | President |
| Lonnie K. Ledbetter | Chief Executive Officer and Chairman of the Board |
| Wyatt D. Blackburn | Secretary |
| David D. Hale | Treasurer |
| David M. Cleff | Assistant Secretary |
| Lonnie K. "Trace" Ledbetter, III | Vice-President |

CORPORATE RECORDS

A review was made of the minutes of the Board of Directors, Certificate of Incorporation and all other pertinent corporate documents, including the appointment of the Delaware Insurance Commissioner as legal agent for the State of Delaware.

TERRITORY AND PLAN OF OPERATION

In accordance with the Company's Business Plan, the Company proposes to provide collateral protection insurance and private passenger auto. All business will be produced through Managing General Agents (MGAs).

The Company will provide the aforementioned coverage as a surplus lines company.

AGREEMENTS

The Company will submit all intercompany agreements to the Delaware Insurance Department for approval.

REINSURANCE

As of November 14, 2005, there were no reinsurance assumed or ceded agreements in effect.

SECURITIES-ESCROW DEPOSIT

Under an Escrow Agreement dated August 4, 2005, the Company has established an escrow account with the Wachovia Bank of Delaware, Wilmington, DE, and when licensed will deposit \$250,000 in the aforementioned escrow account.

BONDS

The Company had bonds having a fair market value of \$22,890,039, held pursuant to a custodial agreement, by the Frost Bank of Fort Worth, Texas.

The asset was verified by direct confirmation.

FINANCIAL STATEMENT

The following financial condition of the Company as of November 14, 2005, as determined by the organizational examination, is shown as follows:

Analysis of Assets As of November 14, 2005

| | <u>Ledger Assets</u> | <u>Assets Not Admitted</u> | <u>Net Admitted Assets</u> |
|-------|--------------------------|--------------------------------|------------------------------------|
| Bonds | \$22,890,039 | \$0 | \$22,890,039 |
| Total | <u>\$22,890,039</u> | <u>\$0</u> | <u>\$22,890,039</u> |

Liabilities, Surplus and Other Funds As of November 14, 2005

| | |
|----------------------------------|---------------------|
| Common capital stock | \$15,000,000 |
| | 7,890,039 |
| Unassigned funds (surplus) | 0 |
| Surplus as regards policyholders | <u>\$22,890,039</u> |
| Total | <u>\$22,890,039</u> |

(*) Company original documentation called for \$15,000,000 capital and \$250,000 surplus; however, the parent purchased the 1500 no par shares for \$22,890,039 thus resulting in Capital of \$15,000,000 and surplus of \$7,890,039.

SUMMARY OF GENERAL COMMENTS AND RECOMMENDATIONS

1. The Company is a member of an Insurance Holding Company System, and a Holding Company Registration statement is in the process of being filed with the State of Delaware. The Company's direct parent is State National Insurance Company, Inc., a Texas insurer with its ultimate controlling parent being National Insurance Companies, Inc. a Delaware chapter S Corp.
2. The Company proposes to provide collateral protection insurance and private passenger auto. All business will be produced through MGAs. The Company will provide the aforementioned coverage as a surplus lines company.
3. Bonds having a fair market value as of November 14, 2005, of \$22,890,039 were held, pursuant to a custodial agreement, by the Frost Bank of Fort Worth, Texas. The aforementioned Bonds were verified by direct correspondence.
4. The Company's By-laws state that the Board of Directors should consist of not less than three (3) persons. The Company has only two (2) directors. Therefore, it is recommended that the stockholders elect an additional director to comply with the By-laws.

CAPITAL AND SURPLUS REQUIREMENTS

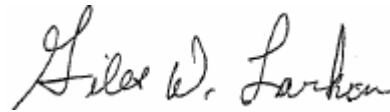
Section 511 of the Delaware Insurance Code requires the following minimum capital and surplus amounts for insurers requesting the authority to write multiple lines of insurance.

| | |
|---------------------------------------|-----------|
| Capital Stock | \$500,000 |
| Gross Paid-in and Contributed Surplus | \$750,000 |

CONCLUSION

Based on the organizational examination, the Company has complied with the capitalization requirements of the Delaware Insurance Code.

The cooperation and assistance rendered by the officers and employees of the Company during the course of the examination are hereby acknowledged.

A handwritten signature in cursive script, reading "Giles W. Larkin".

Giles W. Larkin, CFE
Examiner-In-Charge
Department of Insurance
State of Delaware